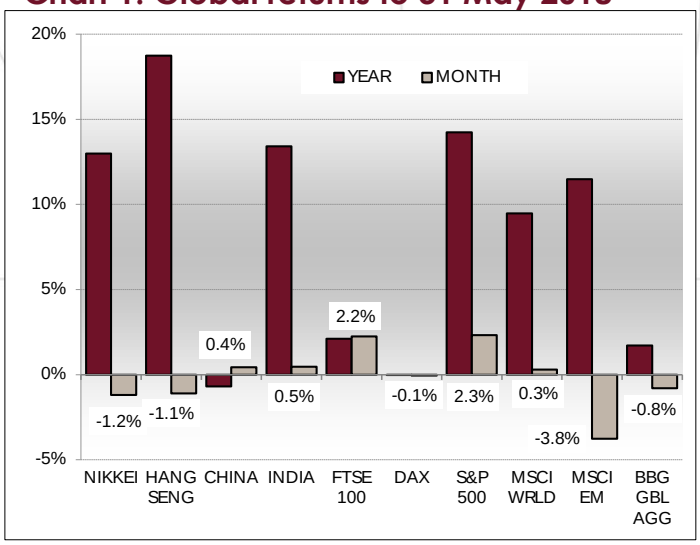
INTERMEZZO
INVESTMENT LETTER
June 2018

Orchestrating Your Wealth
MAESTRO
Masters of Investment

May in perspective – global markets

May featured a mini Emerging Market collapse, ongoing trade disputes between the US and China, and geopolitical tensions such as those in North Korea. There is little doubt, however, that the month will be best remembered for the Italian political developments. The Italian and Spanish political crises weighed heavily on the euro, which declined 3.4% against the dollar. The pound fell 3.4% against the dollar, which remained firmed throughout the month, supported by the resilient state of the US economy; the trade-weighted (DXY) dollar index rose 2.3%. The Turkish lira fell 10.4% and the Brazilian *real* 6.8%, bringing their respective year-to-date declines to 16.4% and 11.4%. Against that background the rand's 1.4% decline and 2.3% year-to-date decline seem out of place. Despite the firm dollar, commodity prices ended the month mixed, although the oil price rose 4.4%, bringing its year-to-date rise to 16.6%. The gold price declined 1.6%, bringing its year-to-date rise to only 0.8%.

Chart 1: Global returns to 31 May 2018



The Bloomberg Global Aggregate Bond index declined 0.8% while the US Bond index rose 0.8%. Evidence of the pain in emerging equity markets can be seen in the 3.8% decline in the MSCI Emerging Markets index. In contrast, the MSCI World index rose 0.3%. The Brazilian equity market fell 10.9% on the back of the economic chaos there. The Greek market declined 11.9% as investors reflected on the events in Italy and the Turkish equity market fell 3.5% ahead of the upcoming election and amidst massive government interference in economic policy. The Indian and Chinese equity markets rose 0.5% and 0.4% respectively. Developed equity markets registered mixed fortunes; the Swiss market declined 4.8%, the Hang Seng fell 1.1%, and the German market 0.1%, but the US equity market rose 2.3%. The NASDAQ index rose 5.3% as tech companies powered ahead, and the S&P Mid and Small cap indices ended up 4.0% and 6.3% respectively.

A public senior school in Shanghai

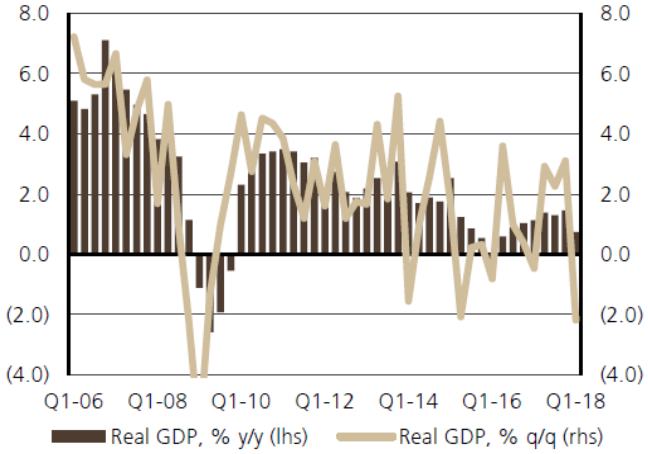
What's on our radar screen?

Here are a few items we are keeping an eye on:

- *The SA economy*: The South African economy declined at a quarterly (qoq) rate of 2.2% during the first quarter (Q1) after rising 3.3% during Q4. This was the fastest rate of decline since Q1 2009 i.e. at the depths of the Great Financial Crisis. The annual growth rate declined from 1.5% in Q4 to 0.8% during Q1, led by a 24% decline in agriculture. The mining sector was also weak, falling 9.9%. Domestic expenditure remained positive, although its Q1 growth rate of 0.6% was significantly less than Q4's 6.9%.

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

Chart 2: South African economic growth (%)



Source: UBS

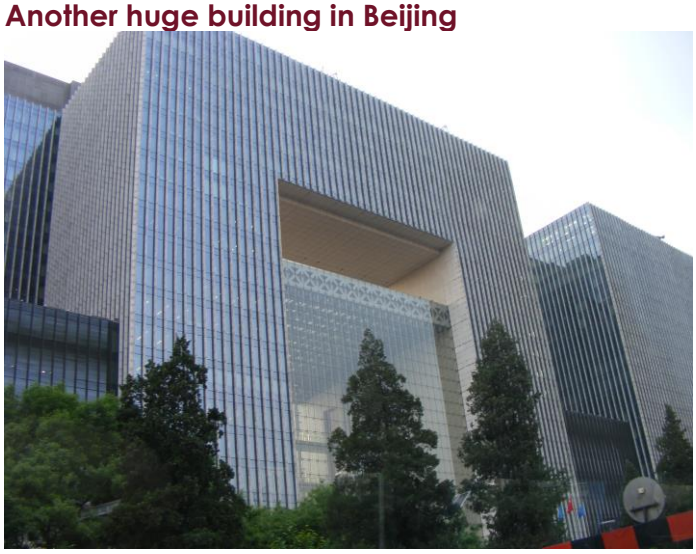
We should note though that many of the declines came off sharp gains during Q4 and there is reason to expect a reasonable rebound during Q2. That said, no matter which way you look at it, the state of the SA economy is dire, and we have no confidence in government's policies to bring about a long-term meaningful change. We doubt the SA economy will grow more than 2% this year, at best, which of course is far below the required rate, meaning all South Africans are getting poorer day by day, in one form or another. As though that wasn't sufficient bad news, the SA Reserve Bank (SARB) March Quarterly Bulletin showed that the current account deficit, SA's perpetual Achilles heel, was far worse than expected, rising to 4.8% of GDP and way above acceptable norms, even for a developing economy. Following a decline of nearly 9% in the rand during June the SARB noted that interest rate increases were possible if the weakness continues – a far cry from the view that the next move in interest rates might be a further reduction. We suspect that, at best, interest rates will remain steady, and at worst, could rise again in the face of a weak rand and rising inflation. Speaking of inflation, the June headline inflation rate was tamer than expected, easing marginally from 4.5% to 4.4%, largely on the back of declining food prices.

- *The US economy*: Data released during May continued to reflect an economy in great shape. Inflation seems to be contained, underpinning the integrity of that growth. In early June, the Federal Reserve (the Fed) increased their target Fed-funds range for the second time this year by 0.25% to between 1.75% and 2.0%. They cited a robust economic outlook, low unemployment and inflation close to its target as reasons for their decision. They also indicated that another two rate increases were likely during 2018. The second reading of (Q1) US economic growth was revised down by 0.1% to 2.2% quarter-on-quarter (qoq) although all indications point to Q2 growth rising sharply. Retails sales rose the most since November last year. Core retail sales i.e. retail sales excluding volatile car and fuel sales, rose 0.8% month-on-month (mom), bringing its annual gain to 5.0%, the fastest growth rate since 2006. US unemployment moved to 3.8%, its lowest level since 1969. Average hourly earnings rose at an annual rate of 2.7%.

One of Bank of China's buildings in Beijing

- *Developed economies*: Eurozone annual headline inflation rose to a 13-month high of 1.9% while core inflation rose to 1.1%. Eurozone unemployment eased slightly to an annual rate of 8.5%. Germany's unemployment rate declined to a fresh record low of 5.2% while the annual inflation rate in May was 2.2%. The French economy grew at a rate of 0.2% qoq, resulting in a 2.2% annual rate. Annual inflation in that country is now 2.3%. Meanwhile in Italy, their economy grew at an annual rate of 1.4% during Q1. Their unemployment rate is currently 11.2% and the annual core inflation rate 1.1%. The Swiss economy grew at an annual rate of 2.2% during Q1. The Australian economy grew at an annual rate of 3.1% and at 1.0% qoq, driven mainly by the export of commodities. The annual inflation rate there is 1.9%. Private consumption and the housing sector are slowing, making it unlikely that interest rates will be raised anytime soon.
- *Emerging economies*: The monthly data release for May showed that Chinese retail sales rose at an annual rate of 8.5%, industrial production at 6.8%, and fixed asset investment at 6.1%. All of these growth rates were lower than expected. India grew at a rate of 7.7% during Q1, up from 7.2% in Q4. The Reserve Bank of India (RBI) increased interest rates by 0.25% to 6.25%, prompted by an increase in the May inflation rate from 4.6% to 4.9%. The Turkish economy grew 7.4% during Q1, but was accompanied by a rising current account deficit and surging inflation. The annual inflation rate rose from 10.9% to 12.5% and producer price inflation is now at 20.2%. Given the sharp deterioration in the important economic indicators and the ongoing political interference, it is unsurprising that the Turkish lira is one of the weakest emerging market currencies so far this year, having declined by 23.1% against the dollar at the time of writing. Not unrelated, the Central Bank of the Republic of Turkey (CBRT) increased interest rates dramatically, from 8.0% earlier in the year, to 17.75%, although it has not stopped the precipitous decline on the lira. Argentina, another country whose currency has declined dramatically, secured the largest stand-by arrangement from the International Monetary Fund (IMF) to date, at $50bn, to assist them with "liquidity issues". Of course, there were a lot of conditions ties to the facility, including a fiscal deficit of 1.3% of GDP and a target inflation rate of 17% (yes, seventeen percent).

Another huge building in Beijing



Charts of the month

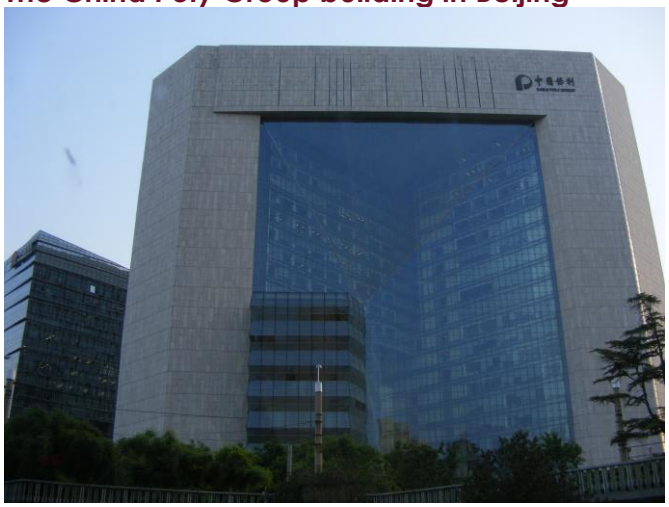
It's the economy – stupid!

I am told it was Bill Clinton's campaign strategist James Carville, who coined the phrase in Clinton's successful 1992 presidential campaign against George HW Bush. Such a simple phrase, but so powerful and true. Yet how remarkable that so few politicians, past, present and probably future, actually get it! It's not exactly rocket science, yet it seems beyond politicians' understanding.

Recent events in Italy, which saw an anti-establishment, rightwing coalition voted into office, provides yet another example of the fact that political leaders just don't comprehend how important the economy is in fashioning the views of the electorate and securing their long-term well-

being. I am 100% certain the South African government hasn't got the message yet, either. They haven't shown any understanding of the economy – President Mbeki maybe, Zuma not at all, Ramaphosa I doubt it – in the 24 years they have been in power. I hold no hope of them "getting it" in the next 24 years either. Remarkably, the likes of Rob Davies and Ebrahim Patel, Ministers of Trade and Industry, and Economic Development (how ironic) respectively, remain in their jobs despite a total lack of evidence of success.

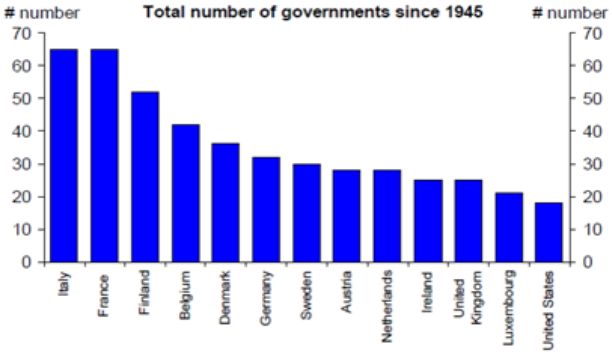
The China Poly Group building in Beijing



Back to Italy: a quick glance at the following charts will show you that we shouldn't be surprised at political developments in Italy. Their socio-economic situation has been the same for decades and their economy continues to stagnate. Their structural problems have not been addressed and they are only going from bad to worse.

To start off with, Chart 3 shows that their government changes nearly every year, having changed 65 times in the past 75 years (surpassed only by France, I note).

Chart 3: Italian government - here today …



Source: Deutsche Bank

The country's debt level has soared unabated since the 1970s - refer to Chart 4 which shows that Italian government debt now stands at 120% of GDP.

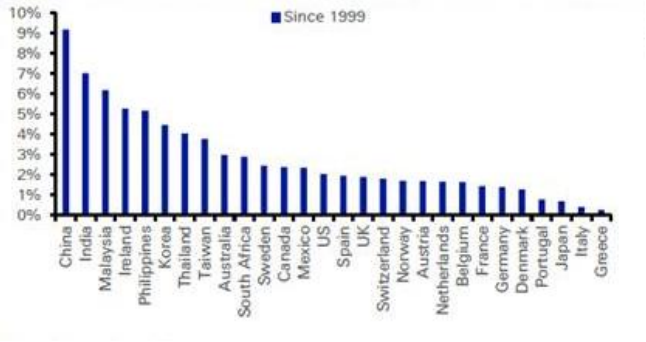
Chart 4: Italian debt – up, up, and away…

Source: Deutsche Bank

More office buildings in Beijing

Charts 5 shows that Italy's growth has been amongst the lowest during the past 19 years, second only to Greece – and we know what happened to Greece, don't we?

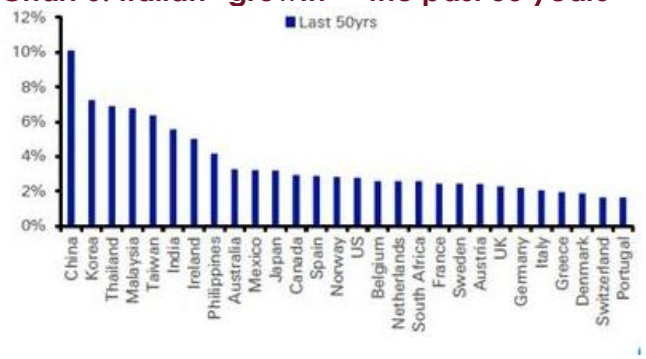
Chart 5: Italian "growth" since 1999



Source: Deutsche Bank

Note where China sits on the Chart 5: 10% per annum for the past 19 years. Even South Africa, at around 3%, has fared better than Italy. Chart 6 also measures the respective growth rates, but over the past 50 years. Again, Italy doesn't feature at all well. China's growth rate remains at 10% - over the past 50 years!! South Africa's growth rate remains largely unchanged over the longer period, at around 3%.

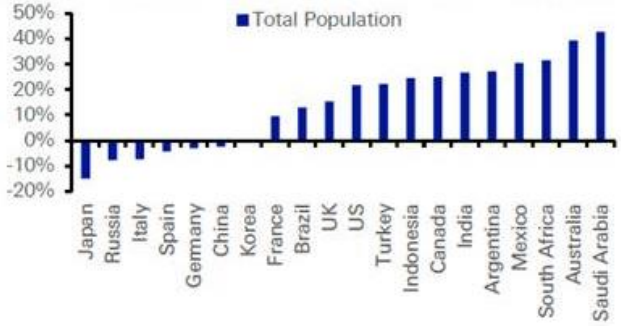
Chart 6: Italian "growth" - the past 50 years



Source: Deutsche Bank

Italy faces one of the worst sets of population demographics out of the G20 nations. Its population has peaked (Chart 7) while its working population, using the cohort of 15 to 64 years of age as a proxy, is set to decline 24% out to 2050 (Chart 8).

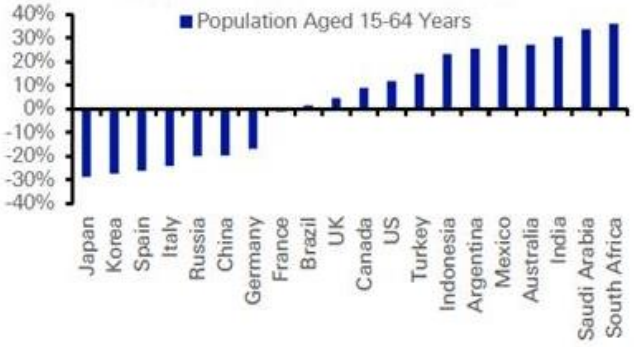
Chart 7: Italian population, now you see it …



Source: Deutsche Bank

So it's fair to say that Italy, as a "problem child" of the Eurozone, is likely to retain that label for a long time to come and will likely continue to be a disruptive influence in the European and global economy. It is likely that conditions there will get worse before they improve, if at all. Perhaps someone should again try telling the new socialist government, "It's the economy, stupid!" Note out of interest where South Africa and China sit on Chart 8.

Chart 8: Italian working population



Source: Deutsche Bank

Quotes to chew on

The return of volatility in 2018

A notable feature of market behaviour in recent months has been the increase in volatility relative to last year. On 30 May, *Deutsche Bank's Jim Reid* wrote the following, which I thought summed up the increase in volatility nicely: "In the US, the S&P 500 closed -1.16% which again saw losses relatively well contained given the unique magnitude of the Italian 2-year (bond) move. However this now makes it 33 days in 2018 when the S&P500 has moved by at least 1% up or down (just under a third of all sessions). In

2017 there were only 8 such occasions when this happened (3% of all trading days). Elsewhere, the VIX jumped 28.7% to 17.02, back to mid-April levels. So yet another reminder that 2018 isn't 2017!!"

Commercial buildings in Chengdu

The trade war initiated by the US – some facts

Investors have been unsettled by the looming trade war initiated by the US and the Trump Administration, and for good reason. The problem with an analysis of possible outcomes is that the very concept of globalization and trade flows is an incredibly complex subject. The one certain outcome is that there are no winners, and consumers and economies will all be worse off.

One example of the complexity of this subject is evident from the following *Deutsche Bank* comment. They suggest that US firms may have sold more to China than Chinese firms to the US – the opposite of what Trump wants us to believe or what he desires: "Our team thinks you should be looking beyond bilateral trade balance figures. Two reasons - (1) it does not capture the sales of goods and services by foreign firms' local subsidiaries (the Foreign Direct Investment or FDI channel); and (2) countries such as Japan and Korea have large business in China that export to the US. Once we factor these in – we find that the US has a trade surplus with China. Officially, the US ran a trade deficit of $0.5trn against the rest of the world in 2017, but once we count in the overseas sales of multinationals, the US has a surplus of $1.4trn. The success of these multinational will come under pressure should a trade war emerge. Remember, US multinationals accounted for one fifth of total employment in the country. The US economy may well suffer more than Trump envisages."

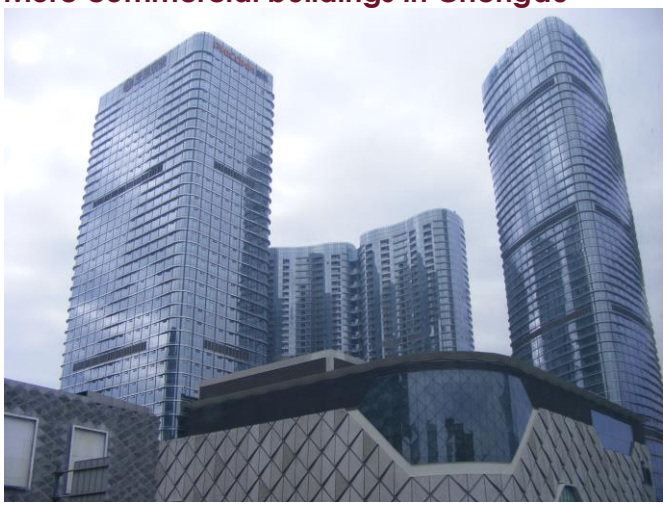
A Budget? What's that?

Elsewhere in this letter I have alluded to the sorry state of the governance of South Africa, the extent of the country's problems, and its dismal future. One project after another is launched by government, more dismal and inappropriate than the one before. The incompetence across all levels of government ensures that none of the projects will ever fulfill its intention, and that it is bound to be characterized by a high degree of corruption. This cocktail of woes has ensured the failure of virtually all State-owned enterprises (SoEs) and impoverished citizens and weary taxpayers, who are leaving the country in droves.

The latest project comes in the form of National Health Insurance, through which Government is aiming to reduce the huge disparity between those who can afford private medical services (at a very high price) and those who can't and have to make do with the public service where it still exists. Rather than fix the public health service, which has been in a steady state of decline for the past 25 years and where in an increasing number of provinces it has for all intents and purposes ceased to exist, Government now wants to place the cost of health services for all citizens on those who are already paying for it privately. Given the state's track record of mismanagement and corruption, one has to believe the NHI will fail spectacularly. The sad aspect is that despite it being doomed to failure, the long-suffering taxpayer, of which there are a rapidly reducing number, will still be called on to pay for it.

In case you think I'm over-dramatizing the situation, let me remind you that the NHI project has been in the planning stages for a number of years already, so you can rest assured the models on which it is based are completely out of date already. In addition, the Bill was tabled by Health Minister Aaron Motsoaledi, appointed by Jacob Zuma in 2009, the man who has presided over the collapse of the SA public health care system. If he and the government he represents cannot manage the current system, how on earth will they manage the NHI? Perhaps the most shocking aspect of the recent tabling of the white papers was the blatant disregard of understanding the potential cost to SA taxpayers. In response to a question of what it would cost, Motsoaledi said "It is not desirable to calculate the cost of NHI, nor will it achieve anything". I rest my case.

More commercial buildings in Chengdu

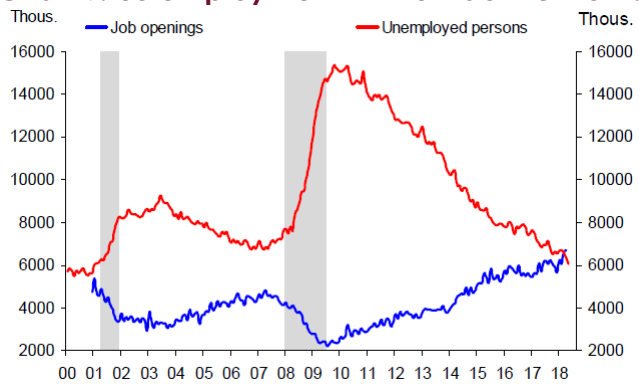


More charts to chew on

The US economy – can it get any better?

We regularly highlight the robust nature of the US economy at present. The latter has paved the way for a profitable environment for global equity investors in recent years. Low interest rates, low inflation and declining unemployment have laid the foundation for great returns. Many investors, including ourselves, are now watching closely for signs of rising inflation. One of the most obvious areas where this will arise is in wage inflation, brought about by the shortage of labour. With US unemployment at 3.8%, the lowest level since 1969, there are simply not enough people to work – this economic reality is seemingly lost on the Trump Administration as they seek to prohibit foreign nationals from moving to the US to seek employment.

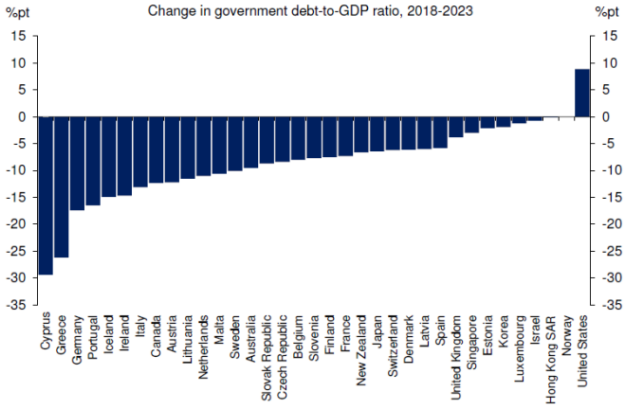
Chart 9: US employment – who'll do the work?



Source: Deutsche Bank

The latest job data out of the US shows that there are now 6.7m job vacancies, but only 6.1m unemployed people – refer to Chart 9 in this regard. This is a sure sign that the US labour market is overheating, a result of which must be that the increase in wages will start accelerating in due course. We are watching closely.

Chart 10: Only the US is growing its debt levels



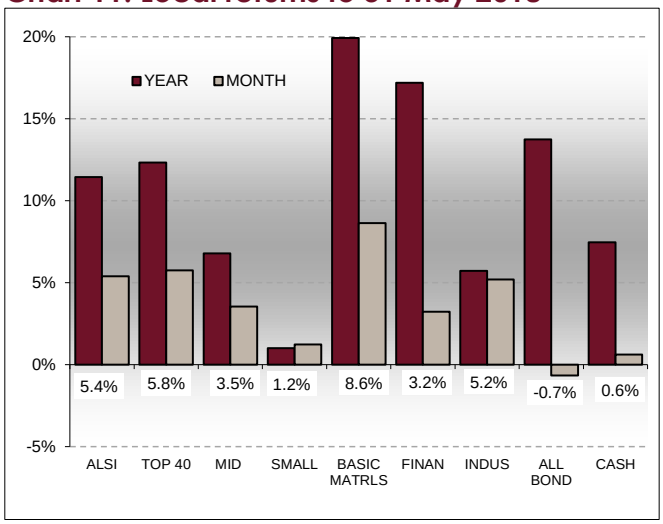
Source: Deutsche Bank

Against that background, according to the IMF's latest forecasts out to 2023, only one country out of the major developed ones is set to increase its debt levels – the US. Refer to Chart 10.

May in perspective – local markets

The All Share index fell 3.5% in May, bringing its year-to-date decline to 4.4%. The Financial index ended 6.3% lower and the Industrial index lost 5.1%. The Basic Materials index, however, ended the month 3.8% higher. Retail shares in particular were weak as concerns grew about the state of the economy in general and the SA consumer in particular. The Small cap index fell 2.4% while the Mid cap index suffered the most, ending the month down 8.4%. The All Bond index fell 2.0%, in sympathy with the turmoil in some other emerging markets, although it is still up 5.3% so far this year.

Chart 11: Local returns to 31 May 2018



The best-performing sector during May was the Industrial Metals sector, which rose 6.2%. The Forestry and Paper sector rose 5.9% and the Mining sector 4.0%. The worst performing sector was the Household Goods sector, which declined 41.7% (Steinhoff was again to blame). The General Retail index lost 12.6%, and the General Industrials index 12.0%.

And even more buildings in Chengdu

So how bad is it really? It's bad, really bad!

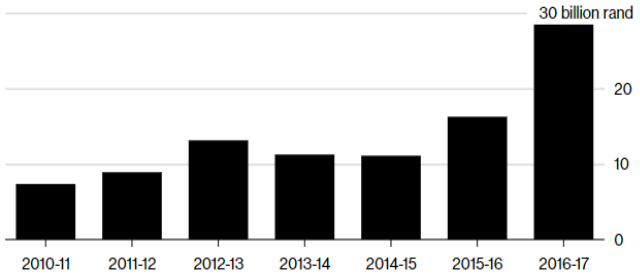
For many months – more like the past three years in fact – we have been urging clients to externalize their assets, at least their financial assets under our management. We went on record as saying that we no longer regarded South Africa as a destination where decent returns can be achieved, and we tabled our reservations about the ability of Government to govern the country and its people. That didn't make us the most popular investment managers on the block, but subsequent developments and returns have vindicated our stance. We continue to hold that view; in our letter to clients in early-June we wrote: "we remain of the view that the steady decline in the South African economic fabric will continue; if anything the pace of decline is likely to accelerate, notwithstanding what the official data show. Although some might differ, we are of the humble view that the country is in a benign state of anarchy at present and effectively ungovernable – the level of governance at all three tiers of Government leaves a great deal to be desired – and this will have a slow but significant and irreversible effect on the country's economic capacity and well-being. For that reason we continue to strongly recommend that investors remit as much of their investable capital offshore."

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

In May alone, Maestro clients reaped a dollar return of 5.5% on their offshore assets, while the All Share index declined 3.5%. Add to that the 1.4% decline in the rand relative to the dollar, so in one month there was a 10.5% differential between local and global returns. At the time of writing, during June so far there has been a further 5% differential in favour of offshore returns, so investors who continue to keep their investments local are bearing a terribly high price for doing so – a cost of around 15% in just less than two months.

It is important that you appreciate our view is not based on some sentimental political view. Our view that the South African economy will continue to decline for many years to come is based on sound economic rationale. There is insufficient space in this publication to list all our reasons why we hold this view, but for now let me touch on one reason, namely the state of local government, or as they are more commonly known, the state of municipalities. The data I share here are extracts from the Auditor-General's testimony to Parliament in May.

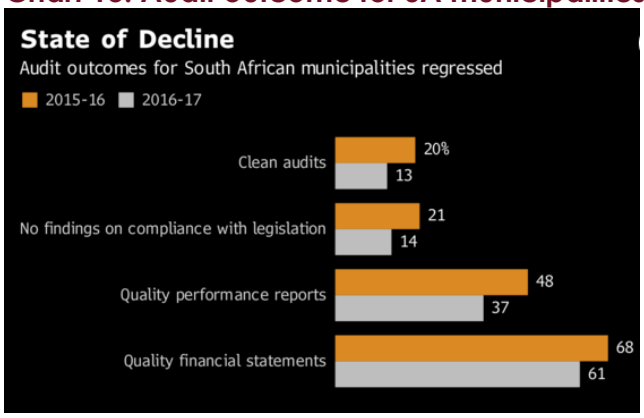
Chart 12: Irregular municipal spending surges



Source: Bloomberg

According to Auditor-General Kimi Makwetu, irregular spending by SA's municipalities surged 75% to R28.4bn in the fiscal year ended March 2017. "There has been no significant, positive change towards credible results; instead, we are witnessing a reversal in audit outcomes," Makwetu said. "Audit counsel in the previous year has, at best, not been implemented, or at worst totally ignored."

Chart 13: Audit outcome for SA municipalities



Source: Bloomberg

The audit outcomes of 45 municipalities regressed while only 16 improved, the Auditor-General said. Not only did the unqualified opinions on the financial statements decrease from 68% to 61%, but the financial statements provided for auditing were even worse than in the previous year. Only 22% of councils were able to provide statements "without material misstatements". Of the 257 municipalities reviewed, only 33 received a clean audit. No municipality in the Free State, Limpopo and North West provinces received clean audits. Material non-compliance with key legislation was evident in 86% of the councils, the highest percentage since 2012-13.

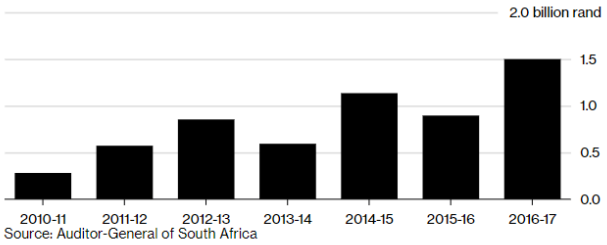
Chart 14: Municipalities with clean audits

Source: Bloomberg

Fruitless and wasteful expenditure has almost tripled since 2013-14 to R1.5bn. One municipality, for example, incurred R164m of spending on a water project that had to be redone from the start by the Department of Water Affairs because of substandard work. In April Finance Minister Nhlanhla Nene said some cities are on the brink of collapse and need to be pulled back from the cusp of

financial ruin. The SA Minister of Co-operative Governance, Zweli Mkhize, recently admitted that 60% of the 257 municipalities are categorized as dysfunctional, or almost dysfunctional.

Chart 15: Fruitless expenditure by municipalities



Source: Bloomberg

As though the state of municipalities isn't bad enough, let me remind you that it is these very municipalities that owe the likes of Eskom billions. Eskom recently disclosed they have R14bn of outstanding municipal debts on their balance sheet which have been outstanding for years. So here's the bad news: not only is Eskom bankrupt, but it is sitting with billions of rands' worth of assets on its balance sheet which are worth nothing. Remember that under this unholy mess sits a taxpayer that is already being crushed by higher taxes used to keep bankrupt state-owned enterprises (SoEs) afloat and to pay a massively bloated government salaries for providing, at best, a sub-standard service.

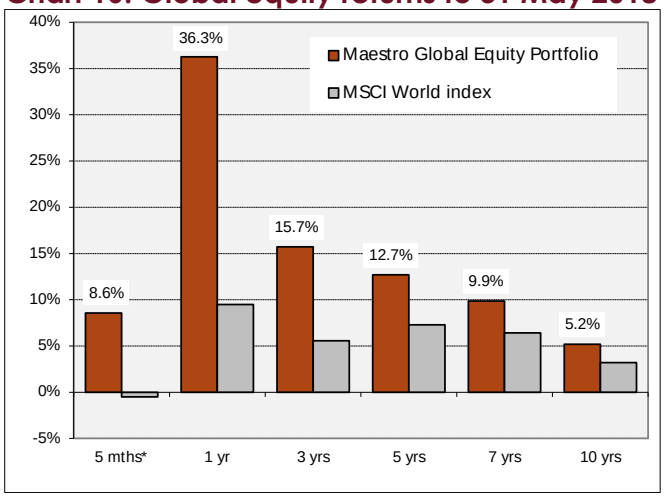
And we are not talking about the state medical health system, which, has for all intents and purposes, collapsed in many parts of the country (refer again to Aaron Motsoaledi's comment in the "Quotes to chew on section" above), or the appalling state of education (refer to the "File 13" section below) or the Eskom load-shedding which is now part and parcel of our lives again. Is it any wonder companies cannot reap decent returns from their external environment, which in turn means no returns for investors? Has anyone noticed the utter decimation of the SA construction industry over the past two years? So even if by some miraculous means we were to "turn the corner", who exactly is going to rebuild the country? While we sit and contemplate that one, we continue to urge investors to externalize their assets as a matter of urgency.

Office and apartment buildings in Chengdu

Maestro's global returns and offering

Speaking of externalizing one's assets, this is an appropriate place to share the returns that Maestro has achieved on the offshore assets under its management. Our "global equity portfolio" – by which we mean the equity portfolio of our global unit trust, Central Park Global Balanced Fund, and the segregated global equity portfolios in our care (they are virtually identical) – continue to do rather well, in absolute and relative terms.

Chart 16: Global equity returns to 31 May 2018



*Un-annualized return

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

More commercial buildings in Chengdu

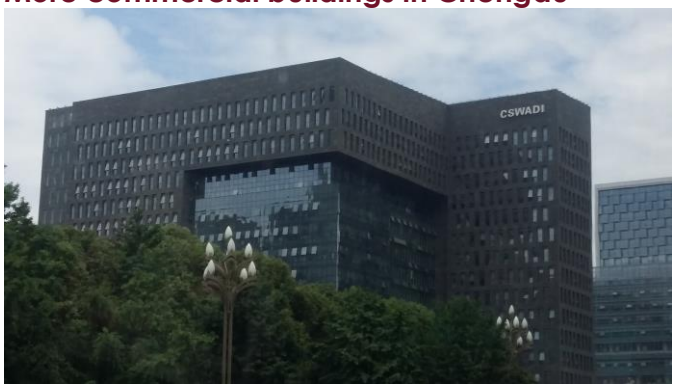
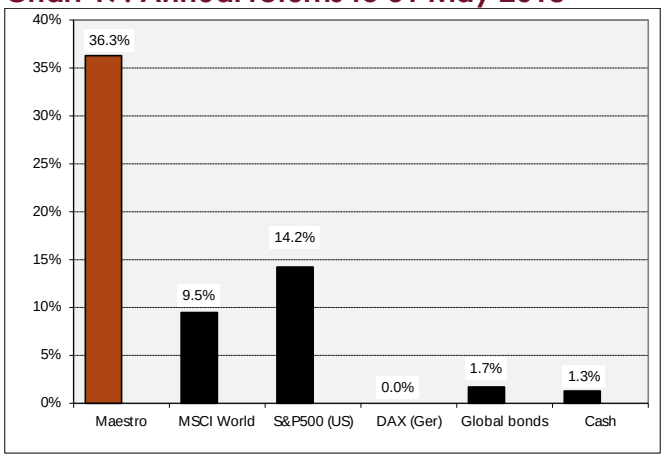


Chart 16 depicts the returns to end-May achieved on the global equity portfolios under Maestro's management. Apart from the excellent recent returns, which are a feature of the chart, our equity returns have also exceeded those of the MSCI World index over all periods during the past ten years. Chart 17 depicts the returns from various equity markets and asset classes during the past year ended 31 May 2018 to place Maestro's returns into perspective. The Maestro returns are reported gross of fees i.e. before fees have been deducted.

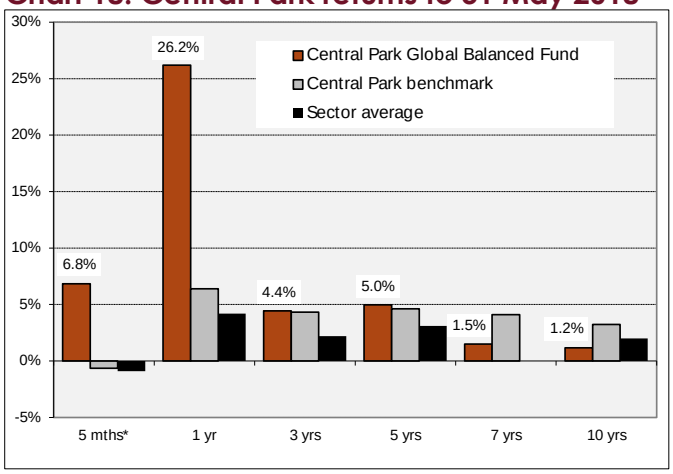
Chart 17: Annual returns to 31 May 2018



*Un-annualized return

The excellent global equity returns have helped our global unit trust, Central Park Global Balanced Fund (Central Park), to also deliver respectable returns, which are shown in Chart 18. The returns are reported net of fees i.e. after fees have been deducted. At the end of May, 83.0% of Central Park was invested in global equities, 0.8% in bonds and 16.2% in cash. You can read more about it by clicking here to visit the latest Fund Summary.

Chart 18: Central Park returns to 31 May 2018



*Un-annualized return

Towards the middle of last year, Maestro's capacity to remit assets abroad was exhausted. Prevailing legislation allowed us to remit abroad 35% of the retail assets under our management. In the February Budget the limit was increased to 40% and our additional allocation was utilized within a day.

Arising from this situation, Maestro established a local "feeder fund" late in 2017 utilizing the life license of Prescient Life. The new Fund is called the Maestro Global Balanced Fund and it allows investors to externalize their assets through a local investment from as little as R1 000 or regular monthly investments starting at R500. All investments into the Maestro Global Balanced Fund are immediately remitted into Central Park, meaning that without having to negotiate any exchange control constraints (remember it is a local investment) investors can externalize their assets.

I should add here that the Fund holds some very attractive benefits, such as a lower Capital Gains Tax (CGT) rate than investors would typically enjoy. By way of example, if a trust is the investor – and trusts cannot ordinarily own global assets directly – then not only can the trust externalize its assets through our Fund, but, provided the beneficiaries are natural

persons, the effective CGT rate is reduced from 36% to 12%. This alone is a significant financial benefit.

Should anyone have any interest in investing into the Maestro Global Balanced Fund, please contact my colleague Shane Packman by clicking here.

Another building in Chengdu – a Tier 2 city

For the record

Table 1 lists the latest returns of the mutual and retirement funds under Maestro's care. Returns include income and are presented *after* fees have been charged. Fund Summaries for each respective fund listed in the table, as well as all the historic returns, are available on our website.

Table 1: The returns of funds in Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**May**	**-2.0%**	**-6.7%**	**-8.1%**
JSE All Share Index	*May*	*-3.5%*	*-4.4%*	*8.0%*
Maestro Growth Fund	**May**	**1.1%**	**-0.3%**	**2.2%**
Fund Benchmark	*May*	*-2.3%*	*-1.1%*	*8.2%*
Maestro Balanced Fund	**May**	**1.1%**	**0.4%**	**3.2%**
Fund Benchmark	*May*	*-1.9%*	*-0.3%*	*8.1%*
Maestro Cautious Fund	**May**	**-0.8%**	**-0.9%**	**1.7%**
Fund Benchmark	*May*	*-1.4%*	*1.5%*	*8.8%*
Central Park Global Balanced Fund ($)	**Apr**	**-1.2%**	**1.2%**	**24.2%**
*Benchmark**	*Apr*	*-0.1%*	*-0.5%*	*8.3%*
*Sector average **	*Apr*	*0.7%*	*-0.5%*	*5.7%*

* 60% MSCI World Index and 40% Bloomberg Global Aggregate Bond Index
** Morningstar USD Moderate Allocation ($)

The old meets the new – note all the bicycles

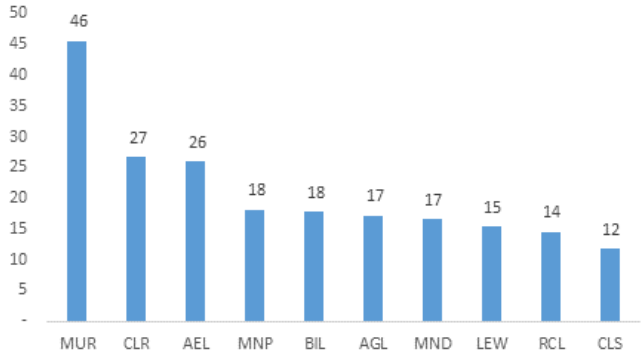
File 13. Things almost worth remembering

It's tough out there…

We appreciate that a lot of people are feeling a bit disillusioned about recent returns from the SA equity market. The All Share index has declined 4.4% so far this year and, as we have warned for so long now, respectable returns in this country are simply not that easy to find.

By way of example, consider Charts 19 and 20, which depict the top and bottom performers on the JSE Securities Exchange (JSE) for the year-to-date (to 22 June). It is apparent from the charts that so far this years the "trick" has been a year to avoid the losers (or as we say in the office, avoid the potholes), rather than seek out the winners.

Chart 19: The JSE's top 10 performers (%)

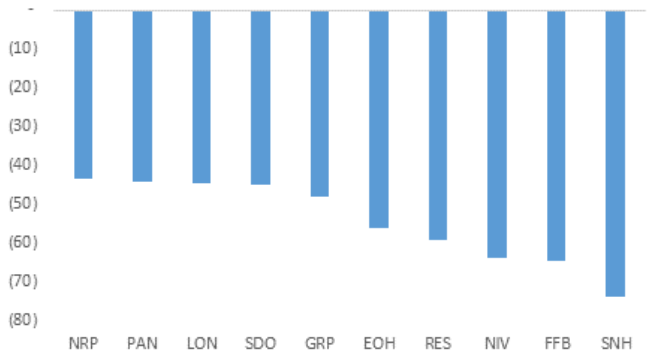


Source: Deutsche Bank

On the JSE so far this year, 117 stocks have declined and only 46 has risen. Only three shares have delivered a return in excess of 20%. The leaders

include M&R, which has only risen on the back of a bid by German firm Aton, Clover Industries, and Altron. Let's face it, these three shares are hardly the stuff that quality portfolios are made of.

Chart 20: The JSE's bottom 10 performers



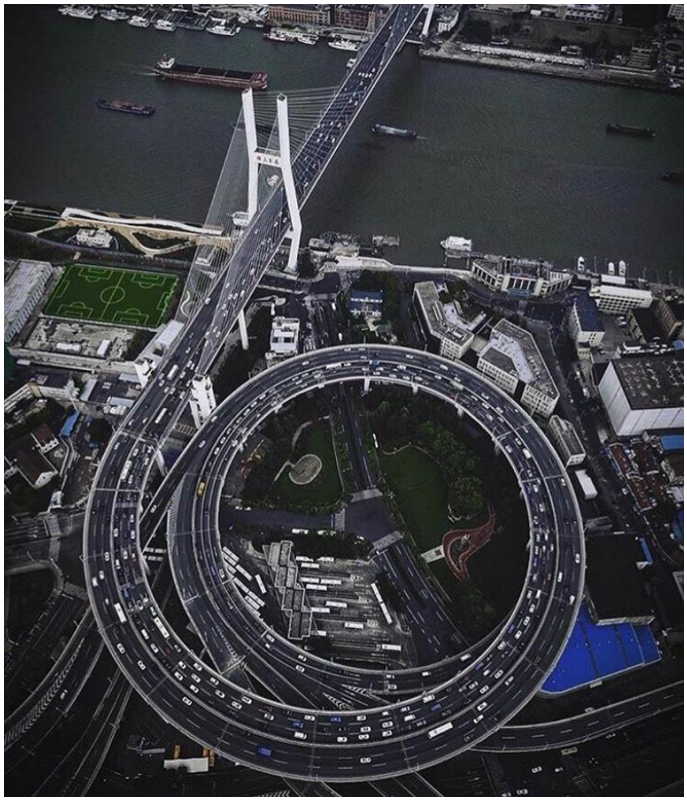
Source: Deutsche Bank

No fewer than 40 shares have declined by more than 20% on the JSE so far. The worst performers include Steinhoff, Fortress REIT, Niveus Investments, Resilient Property Fund, and EOH, all of which have tumbled more than 50% - and we are not even halfway through the year. An indication of how weak the market has been, is to consider that for the five months to end-May, the Large cap (Top40), Mid cap and Small cap indices have all declined, by 4.0%, 8.6%, and 2.5% respectively. At the risk of sounding like a stuck record, we continue to urge investors to externalize their assets, because we have little reason to believe that the weak market conditions will improve.

And in case you remain unconvinced …

We have been rather negative in this edition of *Intermezzo*, but that is not the intention. We use this letter to communicate our thoughts and views to our clients and readers. Seeing that we discuss the condition and future of South Africa, our home, at great length within our team, it is unsurprising that our views "spill out" onto the pages of *Intermezzo*. So see it as coincidental rather than planned that we end off with another depressing window into a country in a steady state of decline.

Shanghai intersection – appreciate its scale



Source: Unknown

If ever there was a sector of the economy and aspect of society that needs to work well in order for the country to make progress in lifting the quality of life and standards of its citizens, and providing hope for its youth, it is education. Yet as all South Africans know, the quality and standard of education in the country is in steady decline, to the extent that public schooling in certain areas exists in name only. As Government goes out of its way to ensure that the pass mark doesn't dip below the previous year, standards are lowered year after year, to the extent that business now knows that the quality of students coming out of schools and universities is simply sub-standard. Despite experts warning Government about the short-sightedness of its policies, and alarm bells ringing all over society, the warnings go unheeded and the State continues to pursue its policies that entrap the youth and doom them to lifelong poverty.

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

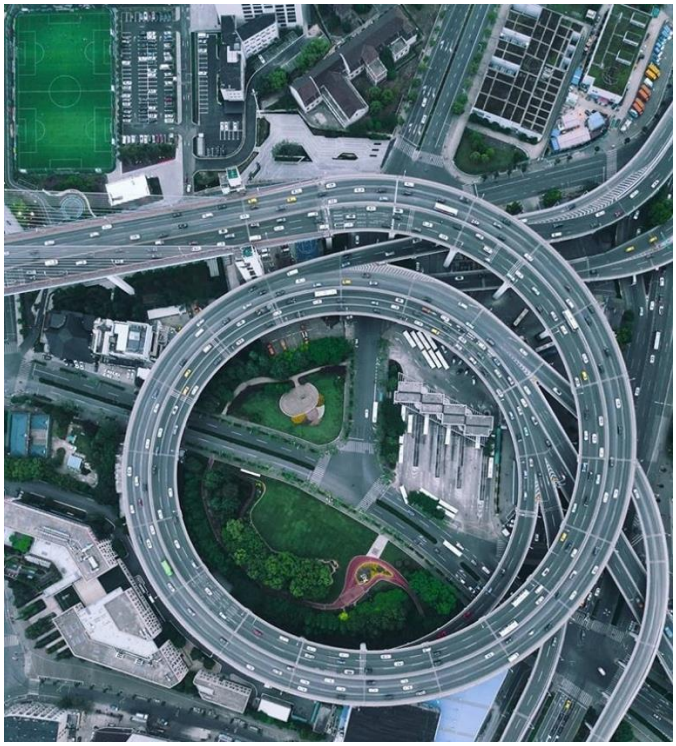
A Buddhist temple in Chengdu – one of many

Am I being melodramatic? You decide for yourself after having read the following: for the first time, the Department of Basic Education has published a full breakdown on subject pass levels in its 2017 School Subject Report. While there are some specific pass conditions for subjects such as Home Language, First Additional Language and Mathematics, at South Africa's current "elementary pass" barrier of 30%, the 2017 matric class passed with a rate of 75.1% - that's what you will read in the Government press release. However, if the pass barrier was increased to 40%, the pass rate would drop to around 54%, and if the pass barrier was 50%, the pass rate would drop to around 33%. If South Africa had to meet the 60% pass barrier seen in some other countries, only 16% of matrics would have made the cut. If you are interested, you can read a useful report on this topic by clicking here.

In closing I again remind that we are not negative on the case for equity investment. We simply repeat here that we think South African investors should give serious thought to externalizing as much of their assets as possible. We remain positive about the prospects for global equity markets. The returns we have achieved provide more than sufficient support for this view. We have the investment solutions to assist all investors, and they are available to you at any time if you contact Shane by clicking here.

Another Shanghai intersection

Note the soccer fields, parks and greenery



So what's with the pics?

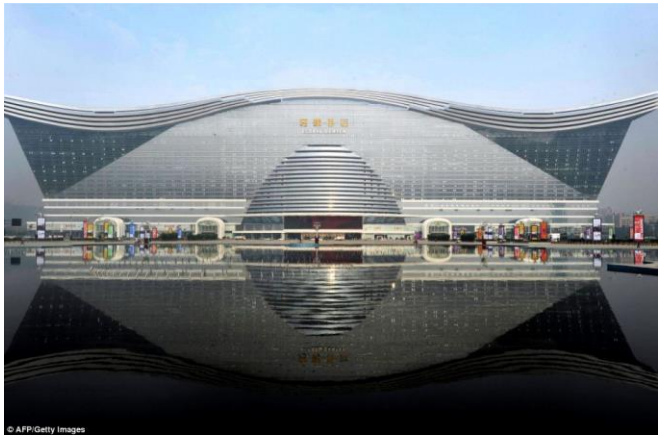
As I shared with you last month, I had the pleasure of travelling to China during May, which was a wonderful privilege and life-changing experience. After having studied and read about the country and its development during the past 20 years, it was indeed a special personal experience. The word that stayed with me long after I completed my visit was simply, "unimaginable".

It is impossible to describe it fully, neither in words nor pictures. However, whereas last month I shared a few pictures that were typical "tourist attractions", in this edition I have specifically shared a bit of the business side of the country. Forgive the quality of the pictures – most were shot on my phone from inside a bus – but I have tried to share the remarkable development of the cities, the variety of the architecture, and the sheer expanse of China's cities. For all the commercial developments, the cities we visited (Shanghai, Beijing, and Chengdu) were well-planned, expansive, green, and

immaculately maintained. There wasn't a cigarette butt, paper, or even a piece of bubble gum visible. Everything works, people are welcoming, hospitable, and friendly and I cannot speak highly enough of their warmth and order. It was a real eye-opener.

Chengdu Global Centre

The largest building on the planet



Apart from the pictures I took, we also drove past the world's largest building, in Chengdu. One cannot capture is properly, it is simply too big: it covers 1.7m^2 and is 500m long and 400m wide! The Chengdu Global Centre is a sight to behold, even from the outside. So rather than try and share anymore of it with you, you can surf the web here and here and here to see more of it. I only share it with you because it encapsulates the extent of the development, the dreams and the possibilities that are becoming a reality daily for and in this country. The West should be afraid – very afraid.

View from the Oriental Pearl Tower, Shanghai

A quick comment on the photo above: the Oriental Pearl Tower viewing platform floor is made of glass; note the elevated pedestrian walkways below (a common feature in the Pudong financial district in Shanghai) and the beautifully maintained gardens, made of sculptured beds of real flowers.

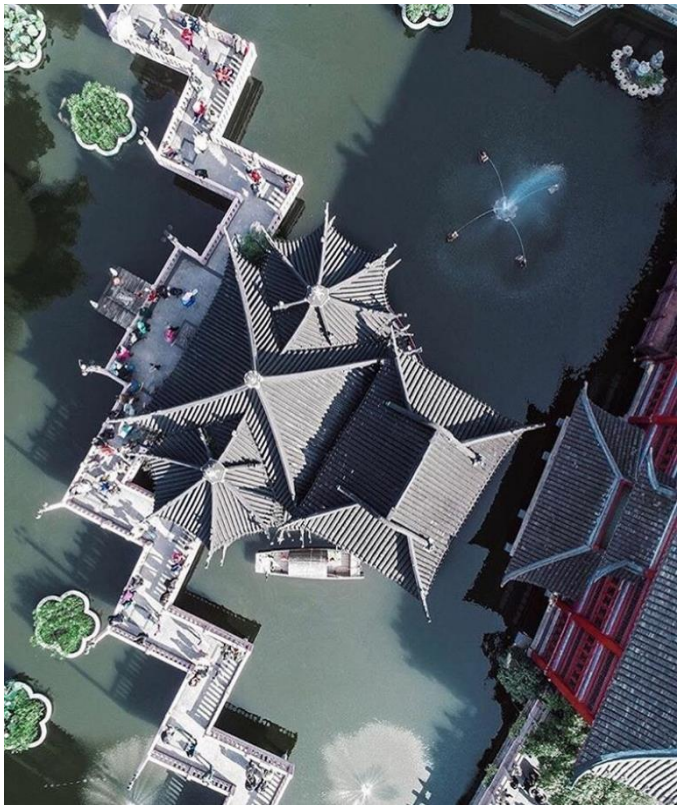
INTERMEZZO
INVESTMENT LETTER

June 2018

Orchestrating Your Wealth

Residential complex, Shanghai

Yu Gardens in Shanghai



Shanghai intersection – note the bicycle paths